Supreme Court, U.S.
FILED
DEC 10 1993
OFFICE OF THE CLERK

No. 92-1839

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

COLGATE-PALMOLIVE COMPANY,
Petitioner,

v.

FRANCHISE TAX BOARD,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate Circuit

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, NATIONAL ASSOCIATION OF MANUFACTURERS, AND UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS IN SUPPORT OF PETITIONER

Of Counsel:
ROBIN S. CONRAD
MONA C. ZEIBERG
NATIONAL CHAMBER LITIGATION CENTER, INC.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

JAN S. AMUNDSON
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 637-3055

TIMOTHY B. DYK
Counsel of Record
BETH HEIFETZ
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

DAVID E. COWLING
JONES, DAY, REAVIS & POGUE
2001 Ross Avenue
Dallas, Texas 75201
(214) 220-3939

Counsel for Amici Curiae

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF THE AMICI CURIAE 1

INTRODUCTION AND SUMMARY OF ARGUMENT . . 3

ARGUMENT 4

I. *CONTAINER* WAS WRONGLY DECIDED 5

A. The Development Of Combined Reporting Demonstrates Its Impropriety When Applied Worldwide. 5

B. *Container* Is Inconsistent With This Court's Earlier Decision In *Japan Line*. 8

II. UNDER THIS COURT'S PRECEDENTS *CONTAINER* SHOULD BE OVERRULED. 12

A. The Result In *Container* Is Doctrinally Anomalous. . 13

1. The Distinction Between Income And Property Tax In This Context Is Unsound. 13

2. The Double Taxation "Inevitability" Requirement Is Inconsistent With This Court's Precedents. 14

3. *Container's* Suggestion Of Disparate Treatment Of Domestic Companies Is Constitutionally Unsupportable 17

TABLE OF CONTENTS (Cont'd.)

Page

B. *Container* Is Unworkable In Practice 19

C. Changed Circumstances Require That *Container* Be Overruled. 20

D. The Presence Of Reliance Interests Provides No Ground For Declining To Overrule *Container* 21

CONCLUSION 23

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

INTEREST OF THE AMICI CURIAE 1

INTRODUCTION AND SUMMARY OF ARGUMENT . . 3

ARGUMENT 4

I. *CONTAINER* WAS WRONGLY DECIDED 5

A. The Development Of Combined Reporting Demonstrates Its Impropriety When Applied Worldwide. 5

B. *Container* Is Inconsistent With This Court's Earlier Decision In *Japan Line*. 8

II. UNDER THIS COURT'S PRECEDENTS *CONTAINER* SHOULD BE OVERRULED. 12

A. The Result In *Container* Is Doctrinally Anomalous. . 13

1. The Distinction Between Income And Property Tax In This Context Is Unsound. 13

2. The Double Taxation "Inevitability" Requirement Is Inconsistent With This Court's Precedents. 14

3. *Container's* Suggestion Of Disparate Treatment Of Domestic Companies Is Constitutionally Unsupportable 17

TABLE OF CONTENTS (Cont'd.)

Page

B. *Container* Is Unworkable In Practice 19

C. Changed Circumstances Require That *Container* Be Overruled. 20

D. The Presence Of Reliance Interests Provides No Ground For Declining To Overrule *Container* 21

CONCLUSION 23

TABLE OF AUTHORITIES

Page

Cases

Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897) 6

Allied-Signal v. Director, Div. of Taxation, 112 S. Ct. 2251 (1992) 5

Allied Stores of Ohio v. Bowers, 358 U.S. 522 (1959) 18

Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977) 18

Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827) 4

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 6

Caterpillar Tractor Co. v. Dep't of Revenue, 618 P.2d 1261 (Ore. 1980) 7

Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 463 U.S. 1220 (1983) 10

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 9, 13, 14

Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983) . . . . . *passim*

Cook v. Pennsylvania, 97 U.S. 566 (1878) 18

Goodman v. Lukens Steel Co., 482 U.S. 656 (1987) 12

Harper v. Virginia Dep't of Taxation, 113 S. Ct. 2510 (1993) 22

Hunt v. Washington Apple Advertising Comm'n, 432 U.S. 333 (1977) 20

Itel Containers Int'l Corp. v. Huddleston, 113 S. Ct. 1095 (1993) 14

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 4, 9, 17

TABLE OF AUTHORITIES (Cont'd.)

Page

Kraft General Foods v. Iowa Dep't of Revenue, 112 S. Ct. 2365 (1992) 20
McKesson Corp. v. Division of Alcoholic Beverages, 496 U.S. 18 (1990) 22
Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976) 4
Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 460 U.S. 575 (1983) 18
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) 13, 14, 15
Monell v. Department of Social Servs., 436 U.S. 658 (1978) 12
Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 14, 15
New York Rapid Transit Corp. v. City of New York, 303 U.S. 573 (1937) 19
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) 22
Patterson v. McLean Credit Union, 491 U.S. 164 (1989) 12
Payne v. Tennessee, 111 S. Ct. 2597 (1991) 12, 23
Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18 (1891) 5
Royster Guano Co. v. Virginia, 253 U.S. 412 (1920) 18
State Railroad Tax Cases, 92 U.S. 575 (1876) 5
Swift & Co. v. Wickham, 382 U.S. 111 (1965) 12
Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818 (1991) 13, 14, 15, 16
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 6

TABLE OF AUTHORITIES (Cont'd.)

Page

United States Glue Co. v. Oak Creek, 247 U.S. 321 (1918) 6
Wallace v. Hines, 253 U.S. 66 (1920) 5
Washington Revenue Dep't v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978) 17
Western Union Telegraph Co. v. Taggart, 163 U.S. 1 (1896) 5
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940) 13

Constitutional Provisions and Statutes

U.S. Const. art. I, § 8, cl.3 4
26 U.S.C. § 482 8
26 U.S.C. §§ 551-58 8
26 U.S.C. §§ 951-64 8
Cal. Rev. & Tax Code § 25110 (West 1992) 22
Cal. Rev. & Tax Code § 26073 (West 1992 & Supp. 1993) 22, 23
Cal. S.B. 671, 1993-94 Reg. Sess. (Oct. 6, 1993), 1993 Cal. Legis. Serv. 3877 (West) 22
Treas. Reg. 1.482-1 et seq. (as amended in 1993) 8
Treas. Reg. § 1.482-1T et seq. (1993) 8

Miscellaneous

Mortimer M. Caplan & Robert H. Elliot, *State Taxation of Multi-National Corporations After Container Corp.* (1983) 19, 20
Richard L. DeLap, *From Moorman to Chicago Bridge: U.S. Supreme Court Decisions Relating to "Unitary" Taxation*, 2 J. St. Tax. 197 (1983-84) 14

TABLE OF AUTHORITIES (Cont'd.)

	Page
Paul J. Hartman, *Federal Limitations on State and Local Taxation* § 9:31 (Supp. 1992)	19
Jerome R. Hellerstein & Walter Hellerstein, *State Taxation I: Corporate and Franchise Taxes* (2d ed. 1993)	6, 16, 17
Charles E. McLure, Jr., *Economic Perspectives on State Taxation of Multijurisdictional Corporations* (1986)	20
E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171 (1970)	7
1 State Tax Guide (CCH) ¶ 10-110	7
4 Cal. Tax Rptr. (CCH) 20,701	8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 92-1839

COLGATE-PALMOLIVE COMPANY,
Petitioner,

v.

FRANCHISE TAX BOARD,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate Circuit

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, NATIONAL ASSOCIATION OF MANUFACTURERS, AND UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS IN SUPPORT OF PETITIONER

INTEREST OF THE AMICI CURIAE*

The *amici curiae* are strongly committed to principles of domestic and international free trade. Each is concerned that California's taxation of multinational businesses under a world-wide combined reporting method creates significant international economic conflicts that will impede trade artificially and restrict the flow of capital in global markets, dampening both foreign investment in the United States and United States investment abroad. In addition, worldwide combined reporting imposes

* The parties' letters of consent have been filed with the Clerk of this Court pursuant to this Court's Rule 37.3.

substantial burdens, both financial and administrative, on multi-jurisdictional companies engaged in foreign commerce. These *amici* believe that *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), was wrongly decided and should be overruled.

The **Chamber of Commerce of the United States of America** is the largest federation of business companies and associations in the world. With substantial membership in each of the 50 states, the Chamber represents approximately 220,000 businesses and organizations and serves as a major voice of the American business community. It has a strong interest in tax measures that affect the competitiveness of U.S. industry and the U.S. economy.

The **National Association of Manufacturers** (NAM) is a non-profit voluntary business association comprised of more than 12,000 manufacturing and related businesses operating in the United States and worldwide. NAM supports a taxing system that encourages the competitiveness of U.S. manufactured goods in domestic and foreign markets.

The **United States Council for International Business** advances the global interests of American business both at home and abroad. It is the American affiliate of the International Chamber of Commerce, the Business and Industry Advisory Group to the Organization for Economic Development and Cooperation, and the International Organization of Employers. The Council officially represents U.S. business positions in the

main intergovernmental bodies and in dealings with foreign business and foreign governments. Working with its membership of approximately 300 corporations, law firms, and associations, the Council addresses policy issues affecting an increasingly globally oriented American business community. Its objective is to promote an open system of world trade, finance, and investment.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case, together with No. 92-1384, *Barclays Bank PLC v. Franchise Tax Board*, also pending before the Court, presents important questions concerning the scope and viability of this Court's decision in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). In *Container*, the Court upheld California's combined reporting approach to the taxation of U.S.-based corporations with foreign subsidiaries. Under that approach, a taxpayer's net income is calculated on the basis of all phases of the operation of an enterprise, even where accomplished through separately incorporated entities located outside the jurisdiction.

In *Barclays Bank*, the petitioner notes that *Container* reserved the issue of worldwide combined reporting with respect to foreign-owned multinationals, and urges that, under well-established doctrine, the holding of *Container* cannot constitutionally be applied to foreign parents. In this case, the petitioner urges that, if *Barclays* is decided in favor of the taxpayer, the Constitution requires that similar protection be afforded to domestic parent corporations with foreign subsidiaries.[1] These *amici* agree with the petitioners in both *Barclays* and *Colgate*. However, these *amici* suggest that this Court adopt a more direct and coherent solution to this complex problem -- that it simply overrule its decision in *Container*.

---

[1] In addition, Colgate raises cogent points concerning the absence of congressional consent to and the presence of a clear federal directive concerning California's regime. *Amici* agree with these arguments.

This Court has consistently subjected state actions affecting foreign commerce to exacting scrutiny beyond that applied to state actions affecting only interstate commerce. Thus, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court expressly held that a state tax provision that affects foreign commerce is unconstitutional if it creates a risk of multiple taxation. Burdens on foreign commerce of this sort undermine the profound constitutional commitment to free trade among nations.

In *Container*, there was no dispute, and this Court agreed, that California's combined reporting method applied worldwide resulted in double taxation. Nonetheless, the tax was sustained. This did not signal a retreat from the *Japan Line* test; to the contrary, in the years following *Container*, the Court regularly has relied on *Japan Line*'s risk of multiple taxation test to measure the constitutionality of state taxes. The inconsistency of *Container* with other decisions of this Court, the unworkability of *Container*, changed global circumstances, and the absence of any reliance interests in the retention of *Container* compel the conclusion that *Container* should be overruled.

ARGUMENT

These cases arise at a time when the United States is endeavoring to eliminate barriers to global commerce. The risk that state laws in general and state taxes in particular will burden international trade has long been clear. Indeed, the Framers of the Constitution provided special protection for foreign commerce (U.S. Const. art. I, § 8, cl.3) and this Court has long recognized that, where foreign commerce is concerned, limits on state authority must operate with special force. *See Japan Line*, 441 U.S. at 446; *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 283 (1976); *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 445-46 (1827). It is against this backdrop of heightened constitutional concern over foreign commerce and relations with foreign nations that the propriety of state taxing actions must be assessed.

I. *CONTAINER* WAS WRONGLY DECIDED.

This Court's decision in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), should be overruled. In *Container*, although conceding that California's use of worldwide combined reporting for U.S.-based multinationals resulted in actual double taxation -- the touchstone for determining constitutionality -- this Court held that the tax did not violate the foreign commerce clause. These *amici* respectfully suggest that the decision was erroneous.

A. The Development Of Combined Reporting Demonstrates Its Impropriety When Applied Worldwide.

At issue in these cases, as in *Container*, is California's method of worldwide combined reporting. The Court's jurisprudence in this area begins with the "unitary" principle. Ever since companies began operating across state lines, the question of the division of income for tax purposes has been present. While states may, consistent with the Constitution, look beyond their borders to "get the true value of the things within it," this Court has long held that the Constitution does not permit this authority "to open to taxation what is not within the State." *Wallace v. Hines*, 253 U.S. 66, 69 (1920).

The "unitary" concept arose in the late 19th century as a mechanism for dealing with the interstate enterprise engaged in transportation or communication. The value of railway tracks or telegraph wires in a state may exceed the actual cost of such property, because a mile of track or wire does not take into account that it is the enterprise as a whole that confers value. *See Allied-Signal v. Director, Div. of Taxation*, 112 S.Ct. 2251, 2258 (1992); *State Railroad Tax Cases*, 92 U.S. 575, 608 (1876). Under the unitary theory, a state could assess a tax by valuing the entire property -- both within and without the state -- as a unit and, through application of a formula, fairly determine the taxing state's share of that value. *See, e.g., Western Union Telegraph Co. v. Taggart*, 163 U.S. 1, 18 (1896); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891).

The Court approved the application of the unitary principle to enterprises lacking physical unity, *see Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 220-21 (1897), and thereafter, to corporate income. In the income tax context, the unitary principle accounted for the fact that a corporation's profits are often earned by a series of transactions beginning with manufacture in one state and ending with sales in other states. *See Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-21 (1920); *United States Glue Co. v. Oak Creek*, 247 U.S. 321, 328-29 (1918). Where income accrues through multistate activities, a single state's taxable share is determined by apportioning a part of the corporation's total income from unitary operations.[2] The apportionment of income is typically based on the so-called "three factor formula" -- the ratio of the taxpayer's in-state payroll, property, and sales to the total payroll, property, and sales of the unitary business. *See Butler Bros. v. McColgan*, 315 U.S. 501, 505-07 (1942).

The next step in the evolution of the unitary business principle was utilizing it in conjunction with combined reporting of multistate income. Under the combined reporting method, "each member of a group carrying on a unitary business computes its individual taxable income by taking a portion of the combined net income of the group," whether or not the members of a group are wholly separate corporate subsidiaries or branches of the same

---

[2] Although the terms "allocation" and "apportionment" are sometimes used interchangeably to describe the division of income among various jurisdictions, "allocation" properly refers to the "attribution of a particular type of income or receipt or property or the like to a designated State, [and] 'apportionment' refers to the division of the tax base by formula." Jerome R. Hellerstein & Walter Hellerstein, *State Taxation I: Corporate Income and Franchise Taxes* ¶ 9.01, at 9-5 n.1 (2d ed. 1993).

corporation. *Caterpillar Tractor Co. v. Department of Revenue*, 618 P.2d 1261, 1262-63 (Ore. 1980).[3]

California has taken that approach further. Under its world-wide unitary combination method, California looks to income earned anywhere, here or abroad, by separate corporate entities, foreign- or domestic-based, engaged in unitary operations. California then apportions that entire worldwide income in determining the tax obligation of the in-state company. *See Container*, 463 U.S. at 162-63.[4]

At the time of *Container*, combined reporting appeared to be non-controversial in the domestic context. Given the stricter standard for judging compliance with the foreign commerce clause set out in *Japan Line*, combined reporting in the foreign context was anything but accepted. Indeed, the federal tax system, along with the systems in all other countries and in most states, was and is based on a very different theory. While the federal government taxes all income earned by United States corporations (and permits the filing of consolidated returns where common ownership standards are satisfied) it takes a different approach in the foreign context.[5] Pursuant to this approach, the income of

---

[3] A number of states currently require combined reporting for domestic unitary businesses (*see, e.g.*, Arizona, California), while others provide for it under certain circumstances (*see, e.g.*, Michigan, New York). 1 State Tax Guide (CCH) ¶ 10-110 at 1071-72. Combined reporting may be required by statute, by regulation, or by directive of the taxing authority.

[4] Of the states requiring combined reporting on a U.S. basis, few extend that requirement to the international arena. *See* 1 State Tax Guide (CCH) ¶ 10-110 at 1071-72.

[5] In a consolidated return, the separate entities of the various member corporations are disregarded, the consolidated income of the entire group is reported on a single return, and a single tax is paid on that income. E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 197 (1970).

separate corporate entities is computed separately, with any transactions among them valued as if they had been conducted by unrelated entities.

To avoid possible tax distortions, the "transfer-pricing" provisions of Section 482 of the Internal Revenue Code were enacted. *See* 26 U.S.C. § 482. Section 482 permits "distribution, apportionment or allocation" of income among entities "owned or controlled directly or indirectly by the same interests," including non-U.S. companies, "in order to . . . reflect the income of such organizations . . . ." *Id.*[6] Detailed implementing regulations were first adopted in 1968 and that approach, refined over time, has continued to the present day. Treas. Reg. 1.482-1 *et seq.* (as amended in 1993); Temp. Treas. Reg. 1.482-1T *et seq.* (1993).

In the more than ten years since *Container*, the Court has not revisited the worldwide combined reporting issue. The matter, however, is far from settled. Courts in states that use worldwide combined reporting have been confronted with countless challenges, both with respect to foreign- and domestic-based multinationals,[7] and foreign governments have registered significant opposition. *See infra* at pp. 20-21.

B. *Container* Is Inconsistent With This Court's Earlier Decision In *Japan Line*.

In *Container*, the Court considered the California tax against the backdrop of its earlier decision in *Japan Line*. There, California had imposed a tax on containers used solely in international commerce. In holding the tax in *Japan Line* unconstitutional, the Court first looked to the standards used to

---

[6] The Internal Revenue Code contains other protections against distortions that may arise from the separate accounting method. *See, e.g.*, 26 U.S.C. §§ 551-58, 951-64.

[7] *See, e.g.*, 4 Cal. Tax Rptr. (CCH) 20,701-722 (listing cases involving worldwide combined reporting pending before the Franchise Tax Board).

measure a tax that implicates interstate interests. To satisfy the Constitution, a state tax on interstate commerce must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to services provided by the state. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). Although the tax in *Japan Line* satisfied those *Complete Auto* standards, the Court stressed that where foreign commerce is concerned, additional considerations come into play: "When construing Congress' power 'to regulate Commerce with foreign Nations,' a more extensive constitutional analysis is required." *Japan Line*, 441 U.S. at 446.

The additional consideration relevant here is whether the state tax at issue creates a "risk of multiple taxation." *Id.*[8] Although the Court in the interstate context can make certain "that no instrumentality of commerce is subjected to more than one tax on its full value" (*id.* at 447), on the international level, the Court is unable to provide that same protection. As a result, even a "fairly apportioned" state tax "may subject foreign commerce to the risk of a double tax burden . . . which the commerce clause forbids." *Id.* at 448 (internal quotations and citations omitted). Considered against that standard, the Court held the tax in *Japan Line* unconstitutional.

---

[8] The second additional consideration is whether the state tax "may impair federal uniformity in an area where federal uniformity is essential." *Japan Line*, 441 U.S. at 448. Uniformity may be frustrated if "international disputes over reconciling apportionment formulae . . . arise" or through retaliation due to an asymmetry in the international tax structure caused by a "novel state tax." *Id.* at 450. In striking down the tax in *Japan Line*, the Court noted that although Congress had not expressly precluded states from taxing "instrumentalities of foreign commerce," the Customs Convention on Containers evidenced federal policy and demonstrated the federal commitment to uniformity. *Id.* at 452.

Container presented a question virtually identical to that in *Japan Line*.[9] Engaged in foreign commerce, the Container Corporation paid tax to foreign countries on income earned abroad. 463 U.S. at 187. At the same time, it was subjected to California's worldwide combined reporting tax, derived by reference to the same income on which foreign governments levied taxes.

The Court conceded that the record in *Container* revealed not simply a risk of multiple taxation, but that there was multiple taxation in fact: "some of the income taxed without apportionment by foreign nations as attributable to [Container's] foreign subsidiaries was also taxed by California as attributable to the State's share of the total income of the unitary business of which those subsidiaries are a part." 463 U.S. at 187. As in *Japan Line*, that multiple taxation arose from "a serious divergence in taxing schemes adopted by California and the foreign taxing authorities." *Container*, 463 U.S. at 187.

Applying the clear standards of *Japan Line*, the California tax appeared unquestionably unconstitutional. Nonetheless, the Court upheld the tax although by only a narrow margin and over a strongly-worded dissent.[10] To do so, the Court devised a new limitation on the double taxation prohibition -- it applies only if the double taxation is "inevitable." 463 U.S. at 188. Double taxation is inevitable, and therefore unconstitutional, only if "one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part . . . ." *Id.* Because the multiple taxation in

---

[9] The constitutional questions posed by the worldwide combined method had come before the Court nearly two years earlier in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.* Although set for reargument at the time the Court noted probable jurisdiction in *Container Corp.*, *Chicago Bridge* subsequently was dismissed by the Court for want of a substantial federal question. 463 U.S. 1220 (1983).

[10] In *Container*, five justices of this Court voted in the majority, and three joined in dissent. Justice Stevens did not participate.

Container -- although quite real -- resulted from two jurisdictions applying different methods of dividing the tax base, rather than from one jurisdiction attempting to tax the entire base, multiple taxation was not "inevitable" (*id.* at 188-89) and therefore, the Court held, the tax withstood constitutional scrutiny.

The Court devised a second limitation on the multiple tax doctrine: a taxing method proposed as an alternative must be guaranteed not to result in any overlap of taxation. 463 U.S. at 191. Because even variations in the application of the arm's-length method might create some overlap, worldwide combined reporting was constitutional. The Court also noted that the tax considered in *Container* was imposed on income, while *Japan Line* concerned a property tax, and that the tax in *Container* was imposed on a U.S. parent corporation, not on a foreign-based multinational. Neither distinction did anything to obviate the fact of actual double taxation in *Container*. *Id.* at 187-88. Finally, the Court suggested that California could achieve the "same economic result" through "rais[ing] its general tax rate . . . ." *Id.* at 195.

The dissent systematically assailed the Court's opinion. First, the double taxation constituted a clear violation of the foreign commerce clause. 463 U.S. at 198 (Powell, J., dissenting). That such taxation was not "inevitable" was immaterial -- "it arises because California has rejected accepted international practice in favor of a tax structure that is fundamentally different in its basic assumptions." *Id.* at 201. As a result, "it is inevitable that the state will tax income under its formula that has already been taxed by another country under accepted international practice." *Id.* at 200.

Next, to the claim that alternatives to California's system might still result in some double taxation, the dissent recognized that the differences in application "are not inherent in the 'arm's-length' system," and are likely to be resolved as international practice becomes more refined. *Id.* at 200-01 (Powell, J., dissenting). Nor was it meaningful that California could have collected the same revenues from Container simply by raising its tax rates.

Political realities would constrain California from raising its general tax rate. *Id.* at 203-04. California could hardly raise the tax rate as to a single taxpayer, or even as to all corporations engaged in foreign commerce, without encountering constitutional attacks under the commerce and equal protection clauses. *Id.*

II. UNDER THIS COURT'S PRECEDENTS *CONTAINER* SHOULD BE OVERRULED.

As this Court recognized just three Terms ago, "when governing decisions are unworkable or are badly reasoned, this Court has never felt constrained to follow precedent." *Payne v. Tennessee*, 111 S.Ct. 2597, 2609 (1991) (internal quotation omitted). In the area of state regulation or taxation of business activities, this Court has, where appropriate, overruled precedents under both the due process and commerce clauses to bring case law into line with coherent doctrine and current factual context. *See id.* at 2609-10 & n.1.

This Court has relied on a variety of considerations in determining whether to overrule a prior decision. In addition to considering whether the precedent provides a workable standard (*see, e.g., Swift & Co. v. Wickham*, 382 U.S. 111, 124-25 (1965)), the Court has looked also to whether the decision is out of step with constitutional doctrine (*see, e.g., Payne v. Tennessee*, 111 S.Ct. at 2909-10), whether the factual context has changed since the precedent was decided (*see, e.g., Goodman v. Lukens Steel Co.*, 482 U.S. 656, 659-62 (1987); *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989)), and whether overruling the precedent would frustrate legitimate reliance interests. *See, e.g., Monell v. Department of Social Servs.*, 436 U.S. 658, 700 (1978). Each of these considerations compels the conclusion that *Container* should be overruled.

A. The Result In *Container* Is Doctrinally Anomalous.

1. The Distinction Between Income And Property Tax In This Context Is Unsound.

To avoid the rule of *Japan Line* -- that a multiple tax violates the foreign commerce clause -- this Court noted that an income tax, rather than a property tax, was at issue in *Container*. 463 U.S. at 188. In support of this distinction, the Court cited language from its decision in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 445 (1980). There, Mobil had challenged Vermont's apportioned tax on dividend income on the ground that New York, the state of commercial domicile, was empowered to tax the same income in full.

Three points are essential: first, the unitary principle itself was developed in the property tax context, and the four-prong test against which the *Japan Line* property tax was considered was borrowed from *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which involved not a property tax but rather a franchise tax on gross receipts. Second, there was no multiple taxation in *Mobil*, because New York imposed no tax at all on the income. Third, the *Mobil* distinction simply acknowledged that property in some situations may be allocated to a single site, while income, whether from dividends or operations, is usually apportioned among the jurisdictions that give rise to the income. But that property may lend itself to allocation rather than apportionment has no relevance to the question present in *Container* and here -- whether there is a risk of multiple taxation. The Constitution is indifferent to how a tax was calculated, so long as the calculation does not result in taxation of out-of-state values. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940); *cf. Trinova Corp. v. Michigan Dep't of Treasury*, 111 S.Ct. 818, 831 (1991) (difference between methods of calculating tax "is one of form and lacks constitutional significance"). One unmistakable indication of taxation of out-of-state values is that a corporation is twice taxed on precisely the same value. Whether it occurs with respect to income or property, such double taxation is unconstitutional. *Container*'s reasoning is therefore anomalous.

2. The Double Taxation "Inevitability" Requirement Is Inconsistent With This Court's Precedents.

In the years since *Japan Line*, the Court repeatedly has held that the risk of multiple taxation will defeat a tax on foreign commerce clause grounds. Just three Terms ago, the Court reiterated that the Constitution is "a defense against state taxes which . . . give rise to serious concerns of double taxation. . . ." *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S.Ct. at 836. And last Term, this Court upheld Tennessee's tax on the lease of containers used in international shipping, pointing to the tax credit offered by Tennessee for taxes paid elsewhere which effectively "reduces, if not eliminates, the risk of multiple international taxation." *Itel Containers Int'l Corp. v. Huddleston*, 113 S.Ct. 1095, 1104 (1993).

The notion that double taxation must be "inevitable" in order to be unconstitutional makes no sense where there is actual multiple taxation. The theory of the majority in *Container* appeared to be that if double taxation did not always result from California's approach, it was irrelevant that it resulted in double taxation in the case before the Court. This suggests a return to a formalism long abandoned in the area of state taxation. With the singular exception of *Container*, in modern times this Court has insisted on an approach to commerce clause questions based on "economic realities" (*Complete Auto*, 430 U.S. at 279) and on "the practical effect of a challenged tax." *Mobil Oil Corp.*, 445 U.S. at 443.[11]

---

[11] The *Container* notion that worldwide combined reporting is unconstitutional only if there is a guarantee that alternate methods will not produce any double taxation comports neither with economic realities nor with constitutional doctrine. While differences in arm's-length methodology may create some tax overlap, they result in little variation in tax liability. *See* Richard L. DeLap, *From Moorman to Chicago Bridge: U.S. Supreme Court Decisions Relating to "Unitary" Taxation*, 2 J. St. Tax. 197, 212-13 (1983-84). Moreover, perfection in apportionment has never constitutionally been required, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978), and a constitutionally-infirm tax cannot be saved simply because alternatives are less than perfect.

Moreover, considered against this Court's state tax jurisprudence, the "inevitability" requirement could never be satisfied in the context of a tax on the income of a unitary business. However egregious, so long as one country is not trying to tax all of the entity's income, no tax could be found to violate the foreign commerce clause. But the constitutional concern that states may be taxing value beyond their borders is implicated whenever multiple taxation occurs, without regard to the particular mathematical niceties from which the multiple taxation arose.

In all events, while the tax does not necessarily result in double taxation in every case, it is nonetheless "inevitable," because it rests on the three-factor formula, whose logic falters when applied internationally. *Container*, 463 U.S. at 202 (Powell, J., dissenting). The theory underlying the three-factor formula, and indeed the basis for its acceptability for interstate commerce clause purposes, is that a dollar of payroll or property or a dollar of sales made in the state produce roughly the same amount of taxable income as a dollar in another state.[12] It is fully recognized that the three-factor formula is only a "rough . . . approximation" of profits (*see Trinova*, 111 S.Ct. at 833), and this Court has acknowledged that neither it nor other apportionment formulas will produce a figure that represents the actual profits earned within a state. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978).

This approximation of the proper division of interstate income is constitutionally tolerable within a country where the commer-

---

[12] The three-factor formula is based on the proportion of a unitary business' total payroll, property and gross receipts located in the taxing state. To determine the portion of income of a multinational that is apportionable to (and presumably taxable by) California, the total worldwide income of the unitary company is multiplied by a fraction which is the average of the three ratios of in-state payroll, property, and sales to total payroll, property, and sales. *See Mobil Oil Corp.*, 445 U.S. at 429-30 n.4, 437 n.13.

cial economy may be considered sufficiently homogeneous. *Cf. Trinova Corp. v. Michigan Dep't of Treasury*, 111 S.Ct. at 833 (permitting departures from three-factor formula in domestic context). But the shortcomings of the three-factor formula in the interstate context are severely exacerbated when transferred to the international arena. Indeed, the assumption of homogeneity applied to the income of a multinational group works serious distortions.

There are marked differences between wages paid and the costs of property in the United States and in other countries. *See* Jerome R. Hellerstein & Walter Hellerstein, *State Taxation I: Corporate Income and Franchise Taxes* ¶ 8.10[3][c] (2d. ed. 1993) (hereafter "*State Taxation*"). Products and markets vary significantly from one country to the next. Thus, application of the three-factor formula leads to a shifting of a disproportionate share of the foreign source income to state taxation. Profit rates differ as well; whenever they are higher in foreign affiliates than in domestic activities, the result is a disproportionate tax on foreign corporations. Indeed, it is widely recognized that the use of the three-factor formula with respect to foreign commerce "result[s] in severe distortion and misattribution to the state of income that, by any acceptable standard, should be attributed to foreign countries." *Id.* at ¶ 8.14[8] at 8-156.[13] As the dissent in *Container* recognized, "[s]ince California is a jurisdiction where wage rates, property values, and sales prices are relatively high, double taxation is the logical expectation in a large proportion of the cases." *Container*, 463 U.S. at 202 (Powell, J.,

---

[13] In dismissing a similar argument in *Container*, the Court rejected the profitability figures provided to illustrate the distortion, on the ground that they were calculated using the arm's length method, which does not provide a perfect picture of income. *Container*, 463 U.S. at 181-82. This is an unworkable result. While arm's-length, like formulary apportionment, is an "imperfect prox[y]" (*id.* at 182), there is no way other than by means of a comparison to demonstrate that formulary apportionment works unfairly in a particular context.

dissenting). Under this Court's precedents, that is an expectation that constitutionally is unacceptable.

3. *Container's* Suggestion Of Disparate Treatment Of Domestic Companies Is Constitutionally Unsupportable.

The holding of *Container* is as inappropriate for Colgate as it is for Barclays. Regardless of the domicile of the multinational, it is undoubtedly foreign income that is being taxed. *See Container*, 463 U.S. 202 (Powell, J., dissenting). And, as the dissent in *Container* acknowledged, "such a tax has the effect of discouraging American investment [abroad]," *id.*, a result not only likely to invoke the ire of certain trading partners, but one that is directly contrary to consistent federal policy, most recently demonstrated by the Executive Branch's negotiation and congressional approval of the North American Free Trade Agreement.

The multiple taxation that results from worldwide combined reporting, *see supra* at 14-16, affects domestic and foreign-based multinationals alike. The Court is in no better position "to enforce full apportionment by all potential taxing bodies" (*Japan Line*, 441 U.S. at 447) in the case of a domestic-based multinational than it is with respect to a foreign-based multinational.[14]

Equal treatment of domestic and foreign-based multinationals is consistent with the underpinnings of the foreign commerce clause. As this Court has recognized, "[i]n granting to Congress

---

[14] In the interstate context, because the Court is able "to enforce full apportionment by all potential taxing bodies" (*Japan Line*, 441 U.S. at 447) and because "multiple burdens logically cannot occur" (*Washington Revenue Dep't v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 746-47 (1978)), apportionment formulas need only meet a basic "fairness" test in order to satisfy the Constitution. In the international context, however, there is no "authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value . . . ." *Japan Line*, 441 U.S. at 447-48.

the right to regulate commerce with foreign nations . . . the Framers of the Constitution believed that they had sufficiently guarded against the dangers of any taxation by the States which would interfere with the freest interchange of commodities . . . by the people of the states with citizens and subjects of foreign governments." *Cook v. Pennsylvania*, 97 U.S. 566, 574 (1878). The need to safeguard that zone of free exchange has led this Court to hold that the commerce clause prohibits preferring one form of "protected" commerce over another. *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 333 (1977). The prohibition operates with added strength here, where such discrimination would result in a "diminution of free competition, [which is] wholly inconsistent with the free trade purpose of the Commerce Clause." *Id.* at 336. Those disincentives represent clear encroachments on the constitutional commitment to unencumbered foreign commerce.

In addition to discouraging investment abroad, a distinction between foreign-based and domestic-based multinationals would have the perverse result of permitting California "to discriminate against a Delaware corporation in favor of an overseas corporation." *Container*, 463 U.S. at 203 (Powell, J., dissenting). That sort of undermining of the level playing field would run afoul of the Equal Protection Clause as well. A tax classification is constitutionally permissible only if it "'rest[s] upon some ground of difference having a fair and substantial relation to the object of the legislation.'" *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 527 (1959) (quoting *Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920)). The classification here is, of course, whether the foreign commerce can be traced back to a foreign or domestic parent. The object of the legislation, it appears, is simply the raising of revenue.

Raising of revenue is certainly critical to any government. *See Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 586 (1983). But that interest, standing alone, cannot justify discriminatory treatment; generating revenue is a purpose of every tax. For equal protection purposes, the classification of taxpayers must have "a fair and substantial

relation to a constitutional non-fiscal object . . . ." *New York Rapid Transit Corp. v. City of New York*, 303 U.S. 573, 587 (1937). California can point to no object that would justify a tax on the foreign income of U.S.-corporations that is not imposed on the foreign income of foreign-based corporations.[15]

B. *Container* Is Unworkable In Practice.

The substantial administrative burdens on foreign commerce that result from worldwide combined reporting demonstrate that *Container* is unworkable in practice. California's deviation from the internationally accepted method imposes enormous accounting and administrative burdens on taxpayers with affiliates in both California and foreign countries. The foreign corporations that are included in a worldwide unitary group are often not otherwise taxable in the United States; indeed, they may not have any transactions with any U.S. entity. As a result, those corporations have no reason to maintain books and records in a manner consistent with local practices, or on a basis reflecting the three-factor formula. *See* Mortimer M. Caplin & Robert H. Elliot, *State Taxation of Multi-National Corporations After Container Corp.* 170-71 (1983). The use of worldwide combined reporting thus imposes a wholly separate recordkeeping system on companies solely for the purpose of meeting California's unusual approach.

Worldwide combined reporting imposes other administrative burdens as well. Differences among states in implementing of the three-factor formula[16] and in making unitary determinations often require both the parent corporation and its foreign subsidiaries to submit substantial information to each taxing state. *See* Paul J. Hartman, *Federal Limitations on State and Local Taxation* § 9:31,

---

[15] That distinction would lead to significant administrative disputes, as there is no settled definition of foreign ownership.

[16] State statutes applying the three-factor formula for interstate apportionment are "studded with variations." *State Taxation*, ¶ 9.06 at 9-23 n.72 and Table 9-1 at 9-8.

at 623 (Supp. 1992). Foreign corporations must prepare and maintain records in United States currency, taking into account the many different exchange rates applicable to various foreign subsidiaries, as well as sharp fluctuations of value. *See* Charles E. McLure, Jr., *Economic Perspectives on State Taxation of Multijurisdictional Corporations* 206-07 (1986). Foreign laws regarding secrecy often make this information difficult to assemble. *See* Caplin & Elliot, at 3.

Such computations and recordkeeping requirements are a costly and burdensome administrative expense that amount to a barrier to foreign commerce -- precisely what the foreign commerce clause was designed to prevent. This Court has recognized that a State statute that has the effect of requiring out-of-state competitors to alter their established practices in order to engage in commerce in the state constitutes a constitutionally proscribed burden on free commerce. *See Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 351 (1977). The rule of *Container* thus works affirmative harm to the values that are central to this Court's commerce clause jurisprudence -- harm that looms increasingly larger "in this era of substantial international trade." *Kraft General Foods v. Iowa Dep't of Revenue*, 112 S.Ct. 2365, 2373 (1992) (Rehnquist, C.J., dissenting).

C. Changed Circumstances Require That *Container* Be Overruled.

In the decade since *Container*, our trading partners have forcefully communicated their disfavor with California's departure from the international norm. Indeed, California's deviation has provoked significant -- and serious -- reaction from U.S. trading partners. The United States "has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world."

Pet. App. at H45.[17] The displeasure of other countries is thus resoundingly clear, a circumstance that counsels overturning *Container*.

In direct response to California's taxation, the United Kingdom adopted retaliatory legislation in 1985, the effect of which is to impose a double taxation burden on U.S. parent companies operating in states employing the worldwide combined taxing method. *Id.* at B22-23. If the legislation is implemented, those companies will no longer be entitled to certain tax benefits relating to the payment of dividends by U.K. subsidiaries. *Id.*[18]

The retaliation takes other forms as well. Some nations have cancelled trade missions to states using worldwide combined reporting. *Id.* at B23. In addition, tensions over this issue have "seriously complicated our economic relations with many of our closest allies" and have been "partially responsible for stalling some bilateral tax treaty negotiations." *Id.* at H45. These events demonstrate a change in circumstances from the time of *Container* and provide a clear basis for overturning that decision.

D. The Presence Of Reliance Interests Provides No Ground For Declining To Overrule *Container*.

Respondent cannot advance any substantial reason for preserving the erroneous rule laid down in *Container*. The

---

[17] Citations to Pet. App. refer to the Appendix to the Petition for Writ of Certiorari in No. 92-1384, *Barclays Bank PLC v. Franchise Tax Board*.

[18] The retaliatory legislation already has injured U.S.-based companies. The possibility of retroactive penalties "impelled many American companies into pre-implementation compliance" (*id.* at B23), with the result that some companies have foregone benefits to which they are entitled under the terms of federally-negotiated treaties. Pet. App. H45.

decision has been sharply criticized since its inception,[19] and challenges from both foreign and domestic multinationals have long been part of the state court landscape. *See supra* at p. 8 n. 7. Moreover, any reliance interests California could assert would be no different from those present in other cases in which this Court has nevertheless overruled commerce clause precedent that has been unworkable or unsound. *See, e.g., McKesson Corp. v. Division of Alcoholic Beverages*, 496 U.S. 18 (1990). And this process of doctrinal evolution, especially in the commerce clause area, is a familiar and expected part of the constitutional regime under which states operate. *See Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 473 (1959) (Frankfurter, J., dissenting).

Significantly, unlike taxpayers faced with a change in tax law, states have a variety of remedies available to avoid disruptions. *See Harper v. Virginia Dep't of Taxation*, 113 S.Ct. 2510, 2519 (1993); *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. at 39-40. For example, states may provide relief only to those taxpayers who paid under protest, or they may "enforce relatively short statutes of limitation applicable to [refund] actions." *Id.* at 45.[20]

---

[19] Opposition to worldwide combined reporting has been widespread and vocal. In fact, as a result of that opposition, California in 1988 enacted legislation permitting a corporate taxpayer engaged in a worldwide unitary business to elect to compute its California franchise tax liability generally on the basis of its United States, as opposed to its worldwide, operations. *See* Cal. Rev. & Tax Code § 25110 (West 1992). Recent amendments liberalize in certain respects the use of this "water's-edge" approach. Cal. S.B. 671, 1993-94 Reg. Sess. (Oct. 6, 1993), 1993 Cal. Legis. Serv. 3877 (West). These changes also suggest that holding the worldwide combined tax unconstitutional will not interfere with reliance interests, as California already has a new approach in place.

[20] In California, credits or refunds must be sought within "four years from the last day prescribed for filing the return . . . or after one year from the date of the overpayment," whichever is later. Cal. Rev. & Tax Code § 26073 (West 1992 & Supp. 1993).

In any event, a state's interest in fiscal stability, although certainly legitimate, does not justify denying relief for its constitutional violations. Under this analysis, *Container*, which was decided by a narrow margin and over a "spirited dissent[]" (*Payne v. Tennessee*, 111 S.Ct. at 2610-11) should be overruled.

CONCLUSION

For the foregoing reasons, this Court's decision in *Container Corp. v. Franchise Tax Board* should be overruled and the judgments of the courts below should be reversed.

Respectfully submitted,

Of Counsel:
ROBIN S. CONRAD
MONA C. ZEIBERG
NATIONAL CHAMBER LITIGATION CENTER, INC.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

TIMOTHY B. DYK
Counsel of Record
BETH HEIFETZ
JONES, DAY, REAVIS & POGUE
1450 G Street, N.W.
Washington, D.C. 20005
(202) 879-3939

JAN S. AMUNDSON
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 637-3055

DAVID E. COWLING
JONES, DAY, REAVIS & POGUE
2001 Ross Avenue
Dallas, Texas 75201
(214) 220-3939

December 16, 1993

Counsel for Amici Curiae